

### 3. Domestic Financial Conditions

Australian financial conditions are assessed as being restrictive. Following the increase in the cash rate target by 25 basis points to 4.35 per cent in November, market pricing implies an expectation that the cash rate may be increased once more in the first part of 2024. Meanwhile, bank bill swap (BBSW) rates are around the peak reached in July and over recent months there have been substantial increases in long-term bond yields and a pick-up in bond market volatility.

Banks' overall funding costs increased a little in the September quarter to be around levels last seen in 2012. Banks have increased both lending and deposit rates by less than the cash rate over this tightening phase. Scheduled mortgage payments have increased in recent months and will continue to rise as borrowers with expiring fixed-rate loans roll off onto higher mortgage rates. Housing credit growth has remained steady at much lower levels than a year ago, with a modest increase in new housing loans alongside a further rise in housing prices. Business credit growth has also remained steady and the Australian dollar is little changed on a trade-weighted basis over recent months.

#### Cash rate expectations have increased a little

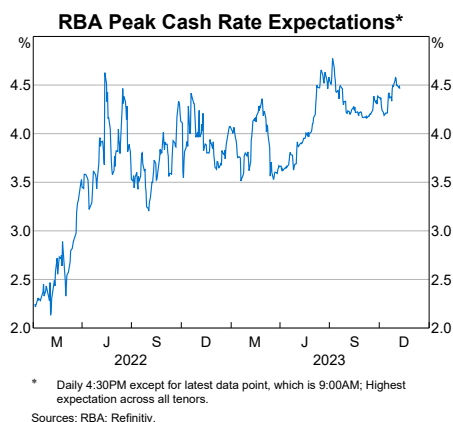
Market participants' expectations for the path of the cash rate, as implied by overnight index swaps (OIS), have increased over recent months (Graph 3.1).

OIS rates rose in response to the release of the minutes of the October Board meeting that

were seen as being somewhat 'hawkish' and following the higher-than-expected inflation data. Since then, the Reserve Bank Board has increased the cash rate target by 25 basis points to 4.35 per cent, and market pricing implies some expectation by participants that the cash rate may be increased once more in the first part of 2024 (Graph 3.2). This is consistent with views of market economists. Moreover, compared with a few months ago, market participants expect the cash rate to remain around its peak for longer.

Transaction volumes in the cash market have been little changed in recent months, with the cash rate determined by market transactions almost every day since early August. The cash rate has remained 3 basis points below the cash rate target.

**Graph 3.1**



## Money market rates have increased a little

Money market rates have increased in recent months to be near their peaks seen around the middle of the year. The spreads between BBSW rates and OIS have also increased, which is not unusual when cash rate expectations are rising. Spreads are a little below the levels reached in mid-2023, when bank issuance of longer term bills was elevated as banks sought to smooth the effect of Term Funding Facility (TFF) repayments. The cost of sourcing Australian dollar funding offshore by issuing short-term US dollar securities and swapping the proceeds in the foreign exchange market has also increased in recent weeks.

## Longer term AGS yields have risen considerably

Over recent months, yields on Australian Government Securities (AGS) have risen considerably alongside similar moves in international markets. The rise in yields was most pronounced for longer term securities, resulting in a steepening of the AGS yield curve. In early November, AGS yields were at their highest levels since 2011 (Graph 3.3).

After declining for most of the past few months, differentials between yields on AGS and US

Treasuries increased in recent weeks, partly in response to the stronger Australian CPI data (Graph 3.4).

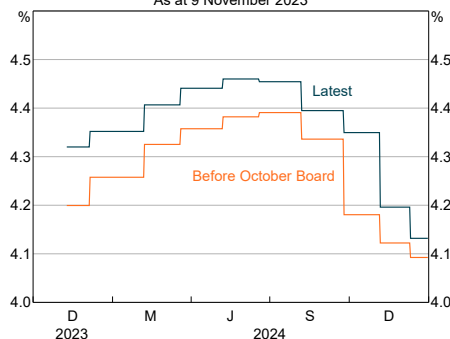
Consistent with overseas bond markets, the rise in longer term AGS yields continues to be largely driven by increases in real yields. Breakeven inflation rates have edged higher, but remain well anchored (Graph 3.5). This is consistent with market participants expecting that the monetary policy tightening will be sufficient to keep inflation around the target range over the medium term.

The spreads between yields on semi-government securities (semis) and AGS have generally declined in recent months (Graph 3.6). Ongoing strong demand from domestic banks to hold semis as part of their high-quality liquid

**Graph 3.2**

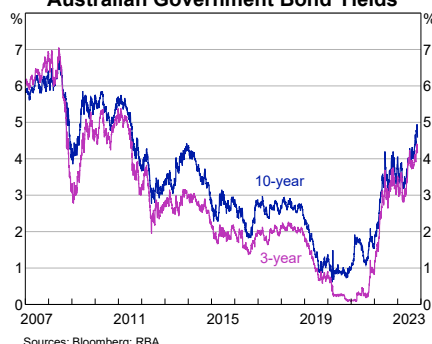
### Cash Rate Expectations

As at 9 November 2023



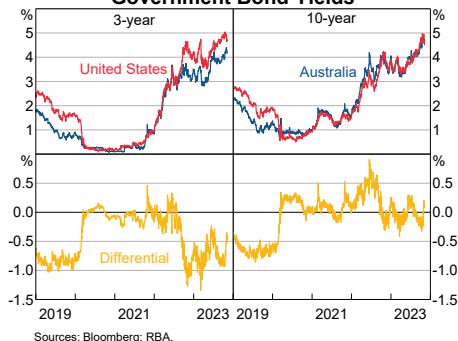
**Graph 3.3**

### Australian Government Bond Yields



**Graph 3.4**

### Government Bond Yields



assets portfolios has supported the decline in semis spreads.

### Government bond markets are functioning well

Bond markets continue to function well. Increased volatility has not adversely affected secondary market bid-offer spreads on AGS and semis, which remain around their lowest levels in recent years. However, there has been a moderate increase in the volatility of semi spreads to AGS. Demand for new government issuance from both domestic and international investors remains strong. A new 30-year AGS was issued in October raising \$8 billion; it was

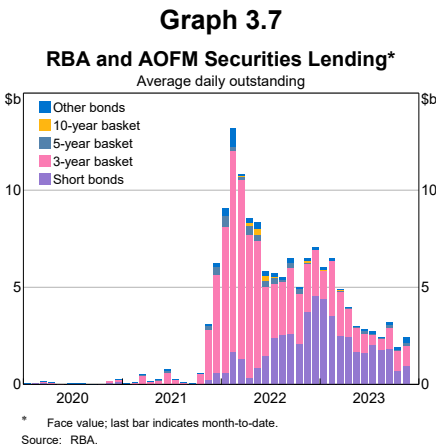
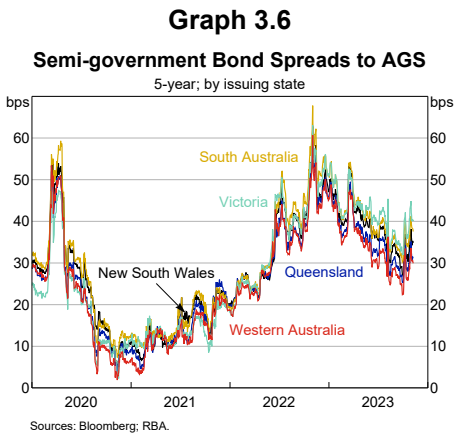
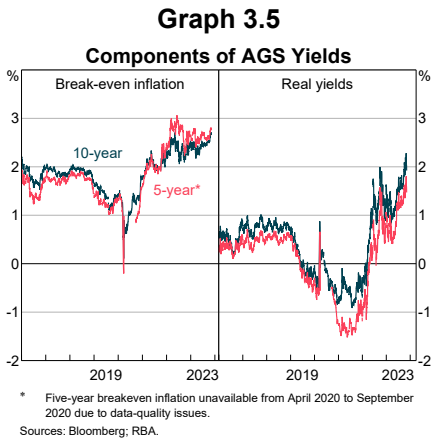
oversubscribed, with \$28.6 billion of bids received.

The Reserve Bank supports the functioning of government bond markets by lending bonds to the market. Demand from market participants to borrow AGS from the Bank has declined from its 2022 peak (Graph 3.7). This reflects easing scarcity due to ongoing issuance of AGS and the maturity of some of the AGS that were purchased by the Bank.

### The size of the Bank’s balance sheet continues to decline

Since the end of the financial year, the size of the Bank’s balance sheet has fallen from around \$600 billion to \$530 billion (Table 3.1). Declines of late have been driven by TFF maturities, with the initial allowance provided to banks now fully repaid (about \$80 billion).

On the liabilities side, Exchange Settlement (ES) balances have fallen to their lowest level since July 2021 as maturing TFF loans have been repaid. Government deposits have also decreased from recent highs due to relatively low net issuance of AGS. Over the coming months, the Bank’s balance sheet is expected to decline more gradually; this will then be followed by a sizeable decline in 2024 as a



**Table 3.1: RBA Balance Sheet**

\$ billion

	End-December 2022	End-June 2023	1 November 2023
<b>Assets</b>	<b>626</b>	<b>598</b>	<b>529</b>
Gold and foreign exchange	86	91	95
Domestic	540	507	433
– Outright bond holdings	327	313	307
– Term Funding Facility	188	176	108
– OMO repo	16	11	13
– Open repo and other	8	7	6
<b>Liabilities</b>	<b>626</b>	<b>598</b>	<b>529</b>
Deposits	519	498	438
– ES balances	453	409	363
– Government and other	66	88	75
Banknotes	104	101	101
Accumulated losses <sup>(a)</sup>	–21	–21	–27
Other (including capital)	24	20	17

(a) Accumulated losses reflect previous mark-to-market losses on the Bank's assets not absorbed by unrealised profit reserves, underlying earnings and the Reserve Bank Reserve Fund at the end of the previous financial year.

Note: Totals may not sum due to rounding

Source: RBA.

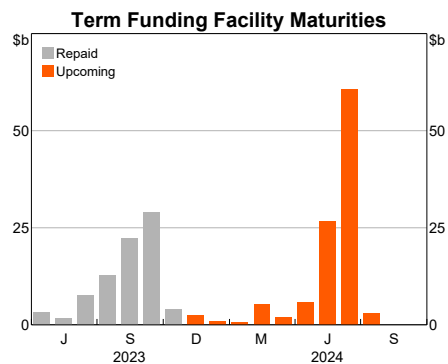
further \$104 billion in TFF loans and \$38 billion in the Bank's domestic bond holdings mature.

### The initial allowance of the Term Funding Facility has matured smoothly

Around \$80 billion of the \$188 billion provided to banks under the TFF has matured, with banks repaying \$64 billion of TFF funding in the September quarter. This was the first of two concentrated maturity periods, with \$96 billion scheduled to mature in the June quarter of 2024 (Graph 3.8). Banks have managed their TFF repayments smoothly to date.

TFF maturities contributed to a period of higher BBSW rates – and so bank funding costs – as banks issued longer dated bank bills to span the maturity period. However, BBSW spreads to OIS remained well within historical ranges and

declined immediately after the peak period of TFF maturities in the September quarter (Graph 3.9). The direct effect of the remaining TFF repayments is not expected to increase bank funding costs materially because much of the

**Graph 3.8**

Source: RBA.

funding is hedged back to floating rates, which have already increased with the cash rate.

## Bank bond issuance remains high

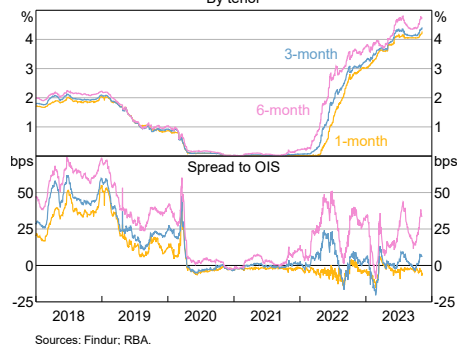
Bank bond issuance was above average in the September quarter, at about \$40 billion. Around two-thirds of this was in the domestic market. Cumulative issuance in the year to date has been strong in both gross and net terms (Graph 3.10).

Yields on three-year banks bonds have remained high over recent months, at around 5 per cent for the major banks, alongside increased swap rates and AGS yields (Graph 3.11). The spread to the swap rate for bonds issued by banks remains in the range seen in the past year and a half.

**Graph 3.9**

### BBSW Rates

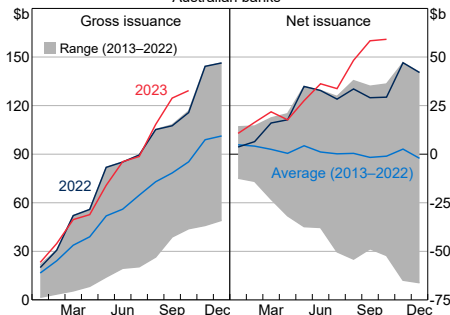
By tenor



**Graph 3.10**

### Cumulative Bank Bond Issuance

Australian banks\*



\* Includes issuance by the NY branches of the major banks.  
Sources: Bloomberg; Private Placement Monitor; RBA.

Banks generally swap fixed-rate payments on newly issued bonds into floating-rate payments to match their floating-rate loans, and so the spread to swap is an important component of bank funding costs.

## Issuance of asset-backed securities has been high over recent months

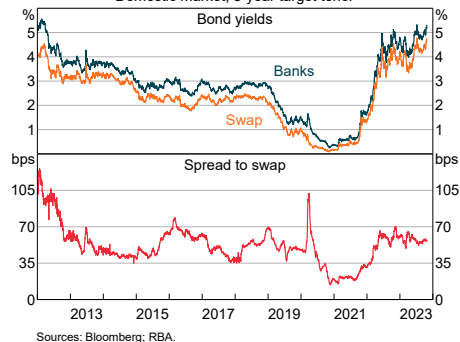
Conditions in the securitisation market remain positive, with the level of issuance in asset-backed securities (ABS) seen in the past few quarters continuing in October (Graph 3.12). Residential mortgage-backed securities (RMBS) accounted for over two-thirds of this. While non-banks have accounted for most of the RMBS issuance in 2023, the smaller banks have increased their issuance in recent months. In addition, and reflecting the favourable conditions for issuers, the first major bank public RMBS deal since mid-2022 recently priced.

Issuance of 'other ABS' has also remained at a high level in recent months relative to its long-run average. Strong issuance of other ABS partly reflects non-bank lenders adjusting their business models. In particular, non-bank lenders have reduced lending for prime housing mortgages, where they have become less competitive compared with banks, and increased other types of loans, such as those for cars and equipment. Spreads on both RMBS and

**Graph 3.11**

### Major Banks' Bond Pricing

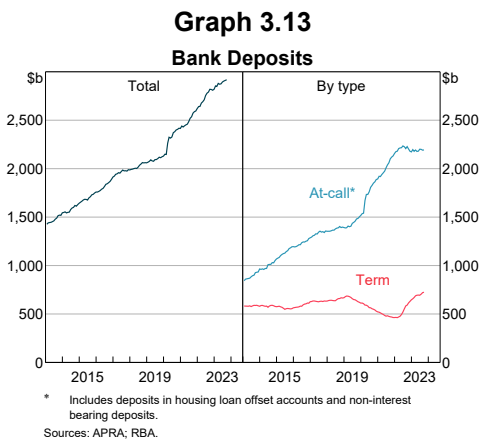
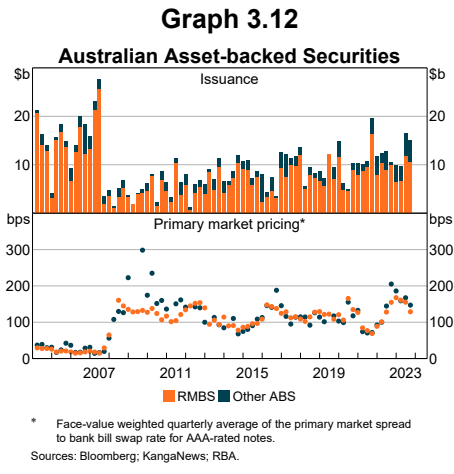
Domestic market; 3-year target tenor



other ABS have continued to narrow in recent months, driven by strong demand from domestic and foreign investors.

### Deposit growth has continued to slow

The total stock of deposits has grown more slowly over the past six months than during the pandemic, in part because slowing credit growth creates fewer new deposits (Graph 3.13); higher issuance of bank bonds has also played a role. Deposits have continued to shift from at-call deposits to term deposits, which typically offer significantly higher returns (see below).

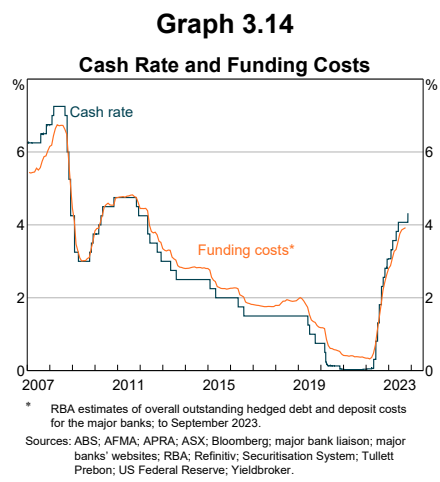


### Bank funding costs have increased further

Banks’ overall funding costs increased a little in the September quarter as banks replaced maturing bonds issued at much lower rates and average deposit rates increased (Graph 3.14). These factors were partly offset by a decline in BBSW rates. Much of banks’ wholesale debt and deposit costs are linked to BBSW rates, either directly or through banks’ hedging activities. This includes banks swapping foreign-currency denominated and fixed-rate liabilities for floating-rate exposures that reference BBSW.

### Deposit rates have risen more on some products than others

The average rate on outstanding at-call deposits – comprising around three-quarters of total deposits – has risen by around 250 basis points since May 2022, which is 150 basis points less than the increase in the cash rate to September 2023 (Graph 3.15). This is partly because around 10 per cent of at-call balances pay no interest. As banks often hedge deposits that pay no interest, their effective cost to banks increases with BBSW rates. Banks have increased advertised rates on ‘bonus savers’ (where depositors must meet certain conditions to receive a higher interest



rate) more than on standard at-call savings accounts.

Average rates on new term deposits have increased by more than the cash rate since the start of 2022, in line with larger movements in BBSW and swap rates (Graph 3.16). Higher term deposit rates also reflect banks' interest in increasing the term deposits share of their funding to address TFF maturities, given the favourable treatment of term deposits in liquidity ratios compared with at-call deposits.

In aggregate, banks have passed on around 75 per cent of the total increase in the cash rate to deposit rates.<sup>[1]</sup> This partly reflects the effect of deposits shifting from non-

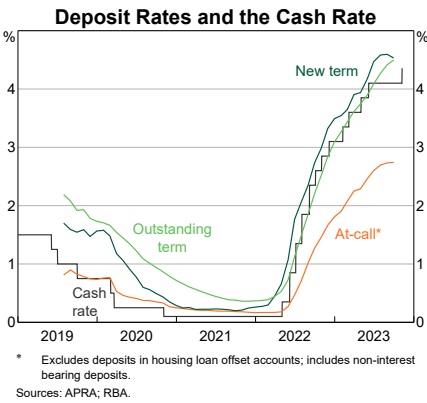
interest bearing and other at-call accounts into term deposits to earn higher interest rates.

### Lending rates have increased by less than the cash rate over the tightening phase

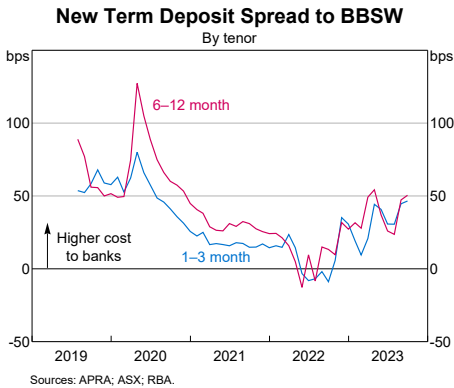
The average rate charged on all outstanding housing and business loans increased by around 315 basis points from May 2022 to September 2023 – 85 basis points less than the cash rate over the same period (Graph 3.17). Housing loans (around two-thirds of total credit) account for most of this difference. Lending rates have increased a little more than deposit rates on average.

The average outstanding mortgage rate increased by around 290 basis points from May 2022 to September 2023 – 110 basis points less than the cash rate over the same period. This divergence reflects the high share of fixed-rate housing loans outstanding that were taken out at low interest rates and, to a lesser extent, the effect of competition between lenders on variable-rate housing loans.

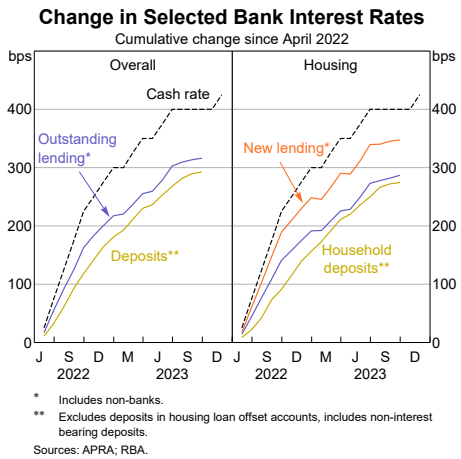
**Graph 3.15**



**Graph 3.16**



**Graph 3.17**



**Table 3.2: Average Outstanding Housing Rates**

September 2023

	Interest rate Sep 2023 Per cent	Change since Apr 2022 Basis points	Change since Feb 2020 Basis points
<b>Cash rate</b>	<b>4.10</b>	<b>400</b>	<b>335</b>
<b>Variable-rate loans</b>			
– Owner-occupier	6.18	332	261
– Investor	6.49	328	253
– All variable-rate loans	6.28	331	257
<b>Fixed-rate loans</b>			
– Owner-occupier	3.15	92	–57
– Investor	3.45	86	–56
– All fixed-rate loans	3.25	89	–61
<b>Loans by repayment type<sup>(a)</sup></b>			
– Principal-and-interest	5.55	287	193
– Interest-only	6.11	288	189

(a) Weighted average across variable- and fixed-rate loans.

Sources: APRA; RBA.

### Variable interest rates on new housing loans have increased over recent months

The average variable rate on new housing loans increased a little faster than the cash rate between June and September as competition for housing loans has eased (Graph 3.18). Even so, the average new variable rate has increased by 40 basis points less than the increase in the cash rate between May 2022 and September 2023 (Graph 3.19). The average outstanding variable rate increased by around 70 basis points less than the cash rate between May 2022 and September 2023, and has declined a little of late (Table 3.2). This reflects the willingness of banks to negotiate discounts to retain existing customers. At the time this *Statement* was finalised, most of the largest housing lenders had announced that they would pass through the November increase in the cash rate in full to their housing reference rates.

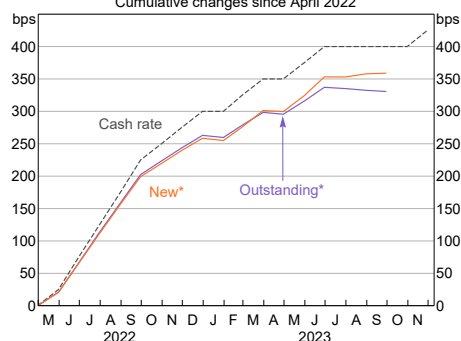
### The fixed-rate share of outstanding housing credit has continued to decline

The fixed-rate share of total outstanding housing credit declined to 22 per cent in September, well below its peak of just under 40 per cent at the start of 2022 (Graph 3.20). This decline largely reflects the rolling off of fixed-rate loans taken out at very low rates during the pandemic that

**Graph 3.18**

#### Changes in Variable Housing Loan Rates

Cumulative changes since April 2022



\* Actual interest rates paid on all outstanding and newly funded variable-rate housing loans.

Sources: APRA; RBA.



have transitioned to variable-rate loans. These fixed-rate expiries have outweighed the smaller inflow of new fixed-rate lending; over recent months, the share of fixed-rate loan expiries each month has exceeded 5 per cent of the outstanding stock of fixed-rate housing loans as at December 2022, while new fixed-rate lending has accounted for less than 1 per cent of this stock.

Most of the remaining fixed-rate loans are expected to expire by the end of 2024. These fixed-rate expiries will see the average outstanding mortgage rate continue to increase as the effect of the rise in the cash rate since May 2022 flows through to a greater share of borrowers.

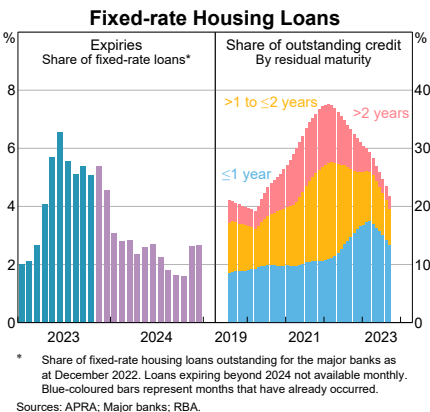
### Scheduled housing loan payments have increased

Scheduled mortgage payments – interest plus scheduled principal – increased to around 10 per cent of household disposable income in the September quarter; this is above the estimate of about 9½ per cent at the previous historical high (Graph 3.21). However, because households have substantially reduced their stock of personal debt in the past 15 years, the

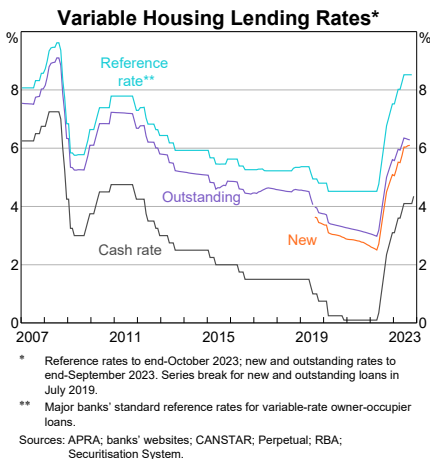
overall debt servicing burden for households appears to be lower than in 2008.

Scheduled mortgage payments as a share of household disposable income have risen by around 2½ percentage points since the March quarter of 2022 and will increase further as borrowers with expiring fixed-rate loans roll off onto higher rates. Based on cash rate increases to date, scheduled mortgage payments are projected to increase to around 10½ per cent of household disposable income by the end of 2024.

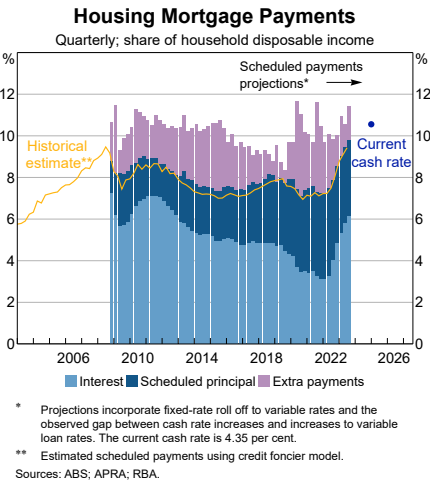
**Graph 3.20**



**Graph 3.19**



**Graph 3.21**



## Extra payments into offset and redraw accounts remain below the pre-pandemic average

Extra payments into borrowers' mortgage offset and redraw accounts have declined as interest rates have increased to be below the pre-pandemic average (of around 2 per cent of household disposable income) (Graph 3.22). While borrowers in aggregate are still adding to this stock of savings, some borrowers have been drawing down funds in these accounts. This is consistent with pressures on disposable incomes due to interest rate rises and increases in the cost of living.

## Total credit growth has remained stable

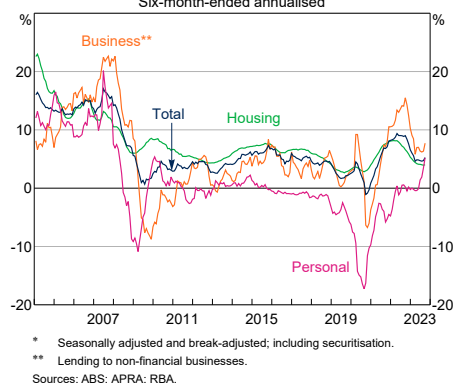
Growth in total credit has remained stable in recent months at around 5 per cent on a six-month-ended annualised basis, 4 percentage points below its peak in late 2022 (Graph 3.23). Housing credit growth has been steady, supported by a modest increase in housing loan commitments alongside the continued rise in housing prices. Business credit growth has also stabilised in recent months.

Personal credit rose strongly over recent months after being little changed since mid-2021. Even so, it remains well below levels prior to the pandemic. The pick-up in personal credit growth

has been driven by an increase in lending by automotive finance companies; this is consistent with recent strength in new car sales, partly reflecting improvements in supply chains (see Chapter 2: Domestic Economic Conditions). There is currently little evidence to suggest that households are, in aggregate, using personal credit to sustain other spending. Meanwhile, spending on credit cards and charge cards that do not accrue interest has increased, but only by a little (Graph 3.24). Outstanding balances for these accounts remain 20 per cent below pre-pandemic levels.

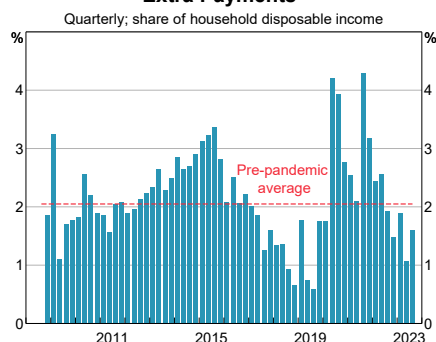
**Graph 3.23**

**Credit Growth by Sector\***  
Six-month-ended annualised



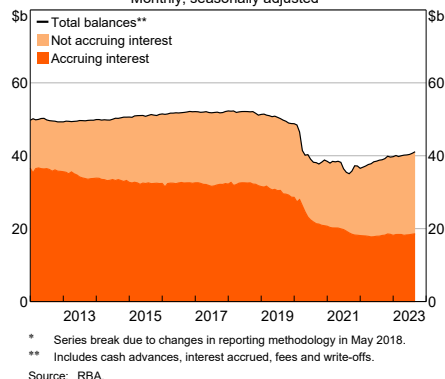
**Graph 3.22**

**Extra Payments\***



**Graph 3.24**

**Credit and Charge Card Balances**  
Monthly, seasonally adjusted\*



### Demand for new housing loans increased a little further in recent months

New housing loan commitments have increased modestly since February alongside the rebound in national housing prices, with investors contributing more than half of this increase (Graph 3.25). Nonetheless, new housing loan commitments remain around 25 per cent below their peak in January 2022 and are at relatively low levels as a share of housing credit.

Commitments for external refinancing (switching to a new lender) remain high but have declined in recent months as competition in the mortgage market has eased. External refinancing continues to be supported by the large number of borrowers rolling off fixed rates, some of whom are switching lenders to obtain a more favourable rate.

### Growth in business debt has stabilised, while corporate bond issuance has been strong

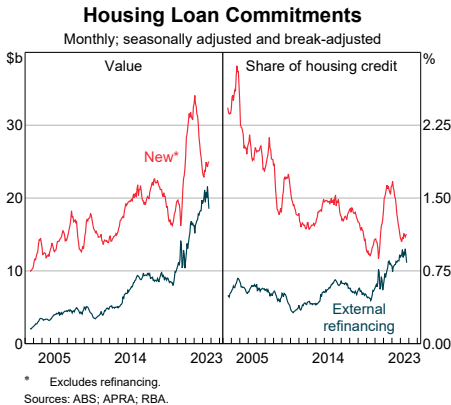
Growth in business debt has stabilised in recent months, as business credit growth has been little changed (Graph 3.26). By contrast, bond issuance by non-financial corporations remained high in the September quarter at \$18 billion. Most issuance was in offshore markets, with

energy and resources companies accounting for more than half of the funds raised.

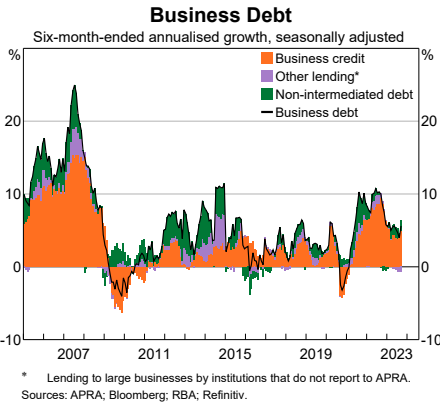
### Higher long-term interest rates have weighed on equity prices

The ASX 200 index has declined a little in recent months but remains broadly unchanged over the year (Graph 3.27). The Australian equity market has underperformed the US market but outperformed other international equity markets since the end of June on a total return basis. Equity prices have been sensitive to recent increases in longer term risk-free rates, the expected path of central banks' policy rates and geopolitical risks in the Middle East.

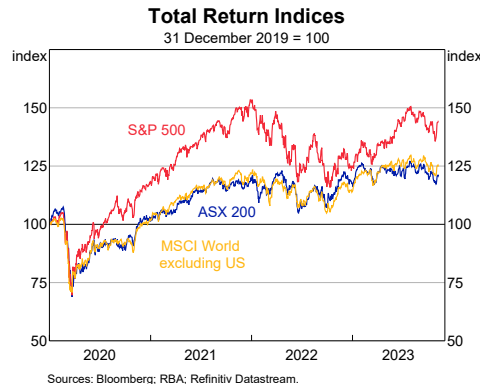
**Graph 3.25**



**Graph 3.26**



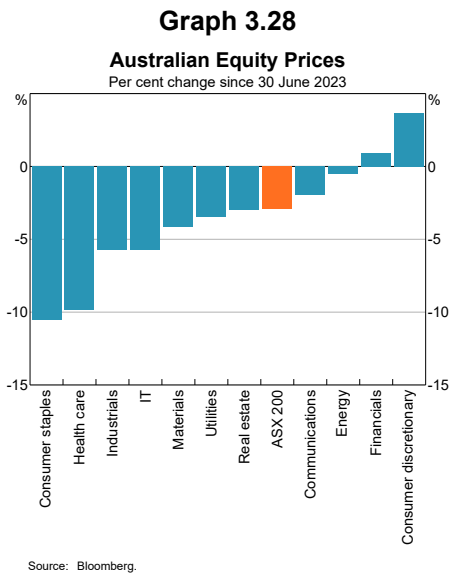
**Graph 3.27**



Consumer staples share prices have declined persistently over recent months, partly reflecting concerns around cost pressures (Graph 3.28). By contrast, consumer discretionary share prices have been more volatile and have recently outperformed other sectors. Health care stock prices have fallen, with some concern around increasingly popular weight-loss drugs lessening the demand for other medical products and treatments. After strong increases earlier in the year, IT stocks have also recently declined. Technology companies are often expected to experience strong growth in profits over the longer term, making their valuations more sensitive to changes in interest rates.

### Equity raisings remain around their lowest levels in a decade

After relatively strong activity in 2021, equity raisings have been very subdued since the start of 2022. Over the year to date, only around \$900 million was raised through initial public offerings (IPOs), largely in the industrials sector (Graph 3.29). Total equity raisings, net of share buybacks, remain around the lowest levels in over a decade.

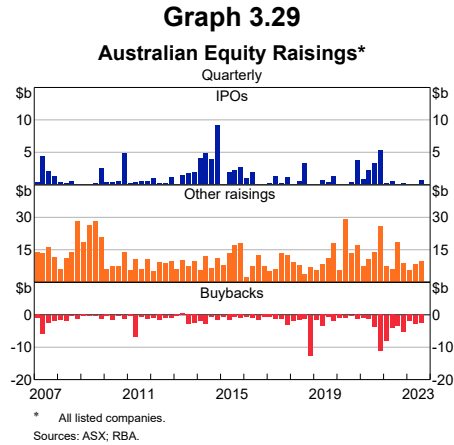


### Australian listed company profits declined in the first half of 2023

Underlying profits of ASX 200 companies declined in the first half of this year relative to the same period a year earlier (Graph 3.30). Less than half of ASX 200 companies reported growth in underlying profits when adjusted for inflation, with ongoing cost pressures commonly cited as a challenge. Profits in resources sectors fell relative to record levels in the first half of 2022, largely reflecting lower commodity prices. By contrast, banks' profits increased slightly, supported by growth in net interest income. Earnings in the real estate sector continue to be adversely affected by declines in the valuations of commercial real estate, but there are limited signs of financial stress among these firms.<sup>[2]</sup>

### The Australian dollar TWI is little changed in recent months

The Australian dollar is little changed on a trade-weighted (TWI) basis and around 2 per cent lower against the US dollar since the August *Statement* (Graph 3.31). The depreciation against the US dollar has mostly reflected broad-based US dollar strength over this period, although this has been partly offset by Australian government bond yields rising by more than those on US Treasuries ahead of the November Reserve Bank



Board meeting (see Chapter 1: The International Environment).

On a longer term basis, the Australian dollar TWI is trading around early-2022 levels, when global central banks began raising their policy rates. Yield differentials between AGS and the weighted average of those of major advanced economies have widened since that time, while the Bank's Index of Commodity Prices has traversed a wide range over this period to be a little lower as a whole. The level of the Australian

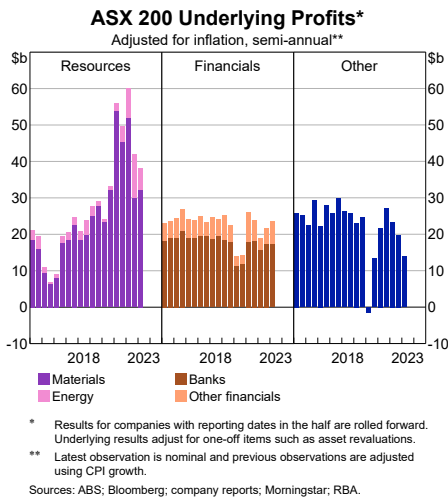
dollar (in real TWI terms) has remained broadly consistent with model estimates implied by historical relationships with forecasts of the terms of trade and real yield differentials (Graph 3.32).<sup>[3]</sup>

### Australia's financial account deficit widened in the June quarter and the net foreign liability position declined further

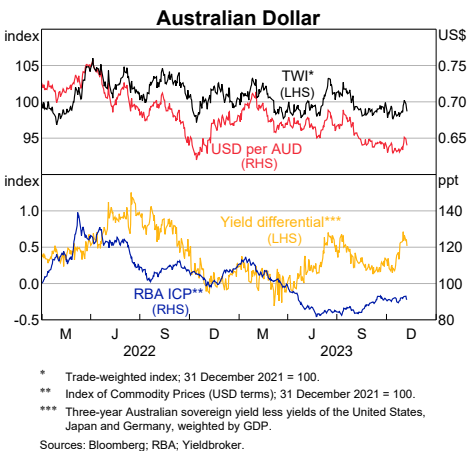
Australia's financial account deficit widened in the June quarter of 2023 as net capital outflows increased (Graph 3.33). The net outflow of capital was driven by a net disposal of Australian Government debt by foreign investors.

Australia's net foreign liability position declined to 32 per cent of GDP over the June quarter – its lowest level since the mid-1980s (Graph 3.34). The decline was driven by a widening in Australia's net foreign equity asset position, which mostly reflected foreign equity prices rising by more than Australian equity prices. Australia's net foreign liability position as a share of GDP has declined by around 30 percentage points since its peak in 2016 due to persistent current account surpluses. In more recent years, rising interest rates have reduced the value of existing external debt, while higher US equity prices and a weaker Australian dollar have

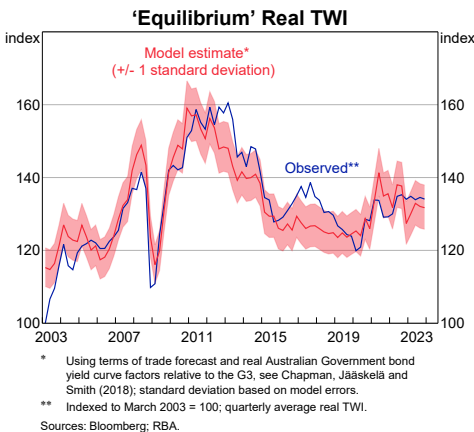
**Graph 3.30**



**Graph 3.31**



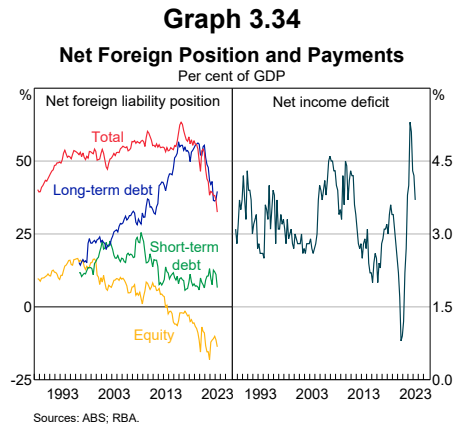
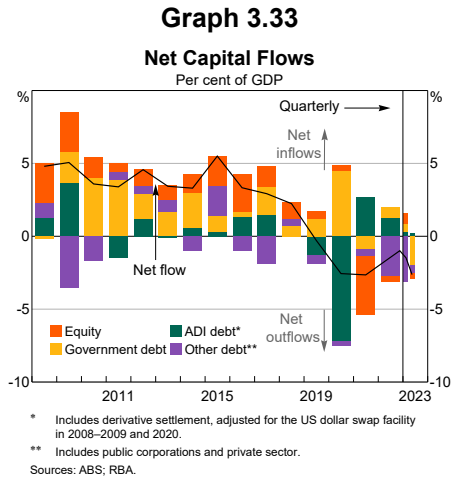
**Graph 3.32**



increased the value of external assets in Australian dollar terms.

The net income deficit – which comprises net payments made on Australia’s net foreign liability position – narrowed to 3.7 per cent of GDP in the June quarter, but remains elevated. The narrowing reflected a decline in primary

income debts, as weaker commodity prices led to a reduction in profits across the mining and resources sector. The net income deficit remained lower than the trade surplus during the quarter, leaving the current account balance in surplus. 🦋



## Endnotes

- [1] See Kent C (2023), ‘Channels of Transmission’, Address to Bloomberg, Sydney, 11 October.
- [2] See RBA (2023), ‘Chapter 2: Resilience of Australian Households and Businesses’, *Financial Stability Review*, October.
- [3] See Chapman B, J Jääskelä and E Smith (2018), ‘A Forward-looking Model of the Australian Dollar’, *RBA Bulletin*, December.